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SENSITIVE

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TAGS: ECON EINV ETRD EFIN SR
SUBJECT: SERBIA AND THE IMF REACH NEW STAND-BY ARRANGMENT

SUMMARY

¶1. (SBU) On March 26, the IMF and Serbia agreed to a 27-month, $4 billion Stand-by Arrangement (SBA). Fueled by the worsening global crisis, the arrangement replaces the precautionary SBA Serbia approved in January 2009. As a part of the SBA, the IMF calls on Serbia to contain its 2009 fiscal deficit to 3% of GDP, cut expenditures, increase temporary revenues, and seek further funding from other International Financial Institutions (IFIs) and donors. In addition, foreign banks have been asked to provide assurances that their subsidiaries will remain well-capitalized in Serbia. The new economic program mandated by the IMF will require Serbia to make substantial and meaningful cuts in expenditures that could face pushback in Parliament. END SUMMARY.

Serbia, IMF Reach $4 Billion Stand-By Arrangement

¶2. (U) On March 26, Finance Minister Dijana Dragutinovic, National Bank of Serbia Governor Jelasic, and IMF representatives announced at a joint press conference that Serbia and the IMF reached an agreement -- subject to IMF Executive Board approval -- on a $4 billion, 27-month Stand-by Arrangement (SBA). Serbia is to receive a total of $4 billion in 2009 and 2010, of which $3 billion available this year. The new arrangement replaces a precautionary SBA approved in January 2009. The enhanced SBA comes after new analysis of Serbia's growing economic difficulties amid the slowdown in foreign investment and external financing caused by the global economic crisis.

IMF Calls On Serbia to Make Provisions

¶3. (U) IMF Mission Chief for Serbia Albert Jaeger explained that there were key provisions Serbia needed to take under the SBA. Serbia must revise its budget to contain this year's deficit to 3% of GDP. Substantial cuts in recurrent expenditures, including a nominal freeze on public wages and pensions through 2010, must also be implemented. Capital and social spending, however, would not be affected. The IMF also called for increases in revenues which the Government announced would be achieved, in part, with a temporary 6% tax on salaries, personal income, and pensions above $170. Serbia would also need to seek additional financial support from other IFIs and donors to fill its financial gaps. In addition, the IMF asked for assurances from foreign banks that they would maintain their commitments to Serbia and that their Serbian subsidiaries would remain well-capitalized (i.e. not abandoned in Serbia). Economy Minister Mladjan Dinkic said the Government was not happy about cutting consumption and increasing taxes, but that the situation would deteriorate further if the Government did not impose such measures.

Governor Jelasic: The Most Significant Adjustment

¶4. (U) NBS Governor Jelasic hailed the proposed adjustments, saying they would mark a "crucial turnaround" for Serbia's fiscal policy. He added that the proscribed cuts in consumption would bring about real and positive results key to Serbia's agreements with commercial banks. Jelasic said he believed that without the IMF deal, banks would likely reduce loans to Serbia which would lead to a drop in GDP and hard currency reserves, pressure on the dinar, and accelerated inflation. So far, the NBS' monetary policy remains unchanged. 2009 target inflation is 6-10% despite new estimates that it will reach 8-12%.

$1.4 Billion Fiscal Adjustment

¶5. (U) In a separate press conference on March 26, Prime Minister Mirko Cvetkovic said the budget deficit was growing quickly due to lower than expected revenues (total budget revenues are 2.5% lower nominally than in the first quarter 2008). He estimated the budget deficit would reach $2.7 billion compared to the previously projected $700 million. Cvetkovic said the Government planned to cover $1.4 billion of the $2.7 billion by cutting $1 billion in expenditures and raising $486 million in revenues. The $1 billion expenditure reduction would come from freezing public sector wages and pensions, cutting federal transfers to municipalities, and slashing the Health Fund, among other reductions. Revenue generation would come from a temporary 6% tax on all income above $170, an increase in property tax, and the introduction of taxes on a number of revenues and on luxury vehicles. This would be the largest fiscal adjustment since 2000. The fiscal adjustments will be reflected in a revised budget that is expected to go to Parliament in April. The proposed tax changes will go to parliament the same day as revised budget for adoption.

Fewer Ministries?

¶6. (SBU) One of the immediate consequences of the tough budgetary cuts the IMF is demanding is a reported deal between Tadic's Democratic Party (DS) and Dinkic's G-17 Plus to cut the total number of ministries by five to ten, with DS, G-17 Plus, and Ivica Dacic's Socialist Party of Serbia (SPS) taking proportional losses. Some observers believe that Tadic plans to use the excuse of budgetary constraints to get rid of problematic ministers, while others predict that cuts will never be implemented and are being discussed only as political theater to counterbalance the sacrifices that taxpayers will soon have to make. (Details septel.)

COMMENT

¶7. (SBU) The SBA calls for bold and substantial budgetary adjustments for the Serbian Government. Such measures will surely spark debate and could be met with resistance in the Parliament. However, the sense of confidence, however little, the SBA would give to banks to maintain their credit level toward Serbia will likely persuade Parliamentarians to responsibly and quickly pass the SBA. End Comment

MUNTER